

THE GEORGE WASHINGTON UNIVERSITY
School of Government

U. S. NAVY GRADUATE COMPTROLLERSHIP PROGRAM

OVERHEAD EXPENSE
AND THE COMPTROLLER

For
SEMINAR IN COMPTROLLERSHIP
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I. INTRODUCTION

This choice of subject was made because many of the governmental expenses can be handled and controlled in the same manner as overhead, and at the higher levels at least, are subjected to controls by Congress and the Bureau of the Budget. One of the measurements of efficiency of supervisors at all levels is the performance within budgetary limitations. Commercial enterprise has found that success or failure frequently is dependent on the proper control of overhead expenses. These expenses can be controlled to the extent that the end results are obtained at a minimum cost by efficient management. The desired end resultsof course are another matter; but whatever the goal, it should be attained at an economical cost.

It is felt that commercial practice regarding overhead expenses should be investigated because practically all such practices can be applied to governmental expenses. One of the methods of control is the use of a budget, which is gaining wider acceptance. The Comptroller quite frequently is in charge of the budget or furnishes a high proportion of information used in its preparation, and furnishes reports of performance which show budget costs and actual costs.

The subject matter is quite extensive, and actual applications are as varied as there are situations. There are more and more books and articles being published on the subject.

The subject matter is quite extensive, and
several suggestions have been made as to the
form and style and articles have been
on the subject.

II. DESCRIPTION OF OVERHEAD

Overhead includes those expenses or costs of doing business which cannot be identified directly with a unit product of the business. It is the indirect expense as contrasted to the direct costs. As a general rule, such expenses can be shown as:

- (a.) Indirect production costs
- (b.) Distribution expense
- (c.) Administrative expense

A manufacturing concern normally would have expenses in all three categories. In the process of manufacture, much of the labor and material costs can be identified directly with the product; and are shown as charges to direct labor and direct material. To these costs are added the indirect costs, the overhead, to arrive at the total manufacturing cost, and likewise the net cost per unit. These overhead costs are known as the indirect shop expense; and they include the indirect labor and the indirect material expended by the shop, plus other services which can be identified directly with the shop but not the product (assuming that there is more than one product). These indirect costs include super-

II. IDENTIFICATION OF OVERLAP

Japanese includes those elements on each of
joint business which would be identified directly with
a unit product of the same type. It is the intention
of the Commission to the listed items. As a general

rule, such elements can be shown as

(a) Indirect production costs

(b) Distribution expenses

(c) Administrative expenses

A manufacturer's research committee in the case

concerned in all these categories. In the process of
manufacture, much of the labor and material which can
be identified directly with the product can be shown

as charges to direct labor and direct material. To

these costs are added the indirect costs, the overheads,

in order to the total manufacturing cost, and then

the net cost per unit. These overhead costs are shown

as the indirect share element; and they form the indirect

labor and the indirect material element in the cost. The

other services which can be identified directly with the

cost but not the product themselves form the indirect

share cost element. These indirect costs include wages-

vision, handling, utilities, stationery, and the like. They may include some direct material costs which are so small that it is not worthwhile to include them as direct material. There are other costs of manufacture which cannot or should not be identified specifically with any one shop or process, but which nevertheless are a cost of manufacture and must be calculated. These include real estate taxes, depreciation, insurance, and so forth.

The foregoing is a general description because it is possible to identify costs in a much closer manner. Utilities, for instance, can be metered at each machine, and accordingly much depends on the values involved and on the desires of management regarding breakdowns of costs. These expenses are variously known as Factory Overhead, Burden, Shop Expense, and Loading. The types of expenses noted above are but a few of those to be taken into account.

Distribution expenses include those expenses which have to do with marketing the product--Selling Expense, Advertising Expense, and so forth. A distributor or retail outlet will have few expenses which would be worthwhile to identify with any one item, though there are times when such information is desired. The same idea applies to these costs as to those of a manufacturing business.

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of expenses noted above are not a total shown in the Overseas, Graham, Good Expenses, and London. The expenses, These expenses are primarily shown in the report on the subject of management regarding expenditure of and accordingly with depends on the lines involved and Utilized, for instance, can be entered at each station. It is possible to identify costs in a much closer manner. The foregoing is a general description because

These copies to these courts are of those of a manufacturing

Practically all businesses have general administrative expenses and financial expenses not included in the previous two categories, but which are necessary to the operation. One of the purposes of accounting is to collect these costs and assign them in a manner calculated to give effect to the costs of business at the level desired by management. In a very small business, the owner might be interested only in the grouping of all costs and expenses, whereas, on the other hand, a large business might want all costs definitely identified and prorated to a fine degree. Labor and material costs identified directly to the product are direct costs. For the purposes of this paper, all other costs are Overhead.

The importance of overhead is best illustrated by the markup in retail stores, and by the ratio of indirect charges to direct labor costs in a factory. Frequently the overhead exceeds the cost of the item. One hundred percent markup, for instance, makes the selling price two times cost price; this fact coupled with the fact that the percentage of profit is a small one leads to the conclusion that a slight rise could wipe out the profit. This, of course, does vary from business to business. Material costs can be kept at a low level by good buying practice, and carrying waste and spoilage, can be controlled more easily than overhead because the former is more or less fixed. A varying overhead can turn a

possibly all business were general

unlimited expenses and financial expenses are
involved in the operation and maintenance, but which

are necessary to the business. One of the purposes of

business is to collect from debts and receive from the

business which is also added to the profit of business

at the least business is successful, in a very small

business, the owner must be satisfied with the business

of all costs and expenses, which, on the other hand, a

large business must not only satisfy itself with

the progress to a fine degree, but also with the profit

possibly derived from the business, for the sake of

the progress of the business, the owner must not

be satisfied with the progress of the business.

The importance of business is that it is

the mainstay of the nation, and is the basis of

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profit into a loss--the margin is so close that a large Washington department store considers that its profits come from discounts earned by prompt payment of invoices. It is necessary to recognize the importance of the control of overhead expenses, because if uncontrolled, they can be discovered too late to adjust.

III. FUNCTIONS OF THE COMPTROLLER

The Comptroller (or Controller) is variously described, and his position in the organization varies with the company. Probably the most descriptive phrase is "the figure man of management." The title or the position is not too important, the point that is important is that an efficient management needs and makes use of reports based on figures and the interpretation of that data. Responsibility may be vested in one man or several men, or in one department or several departments. The reports might be accounting reports, performance reports and/or comparative reports. The collection, preparation, analysis, and submission of such data along with recommendations for improvement is a necessary function. Expenses should be kept at a minimum consistent with requirements, and efficiency should be at the highest level.

III. POWER AND THE GOVERNMENT

The Government (or Government) is naturally
desired, and the position in the population is
also the same. The same the most desirable place
is "the first man of government," the title of the
position is not too important. The point that is important
is that an efficient government needs and needs are of
great value in the future and the foundation of that
basis. Effectiveness may be said to be one of several
and, or in one department or several departments. The
people must be in the position of the government. The
and/or comparative results. The collection, organization,
analysis, and utilization of such data along with the
design for improvement is a separate function. The
should be used as a guide to the government and the
and efficiency results are at the highest level.

IV. NATURE OF A BUDGET

One of the methods of control of overhead is a budget. Generally this requires a forecast of the future covering the period of the budget. The demand, condition of the market, sales goals, production goals, cost estimates, and so forth are submitted to management. With respect to overhead, approved expense budgets are released. In the government, appropriations of money are made to cover the budget estimates. In commercial practice, the same principle applies.

"A budget is a forecast, in detail, of the results of an officially recognized program of operations based on the highest reasonable expectation of operating efficiency."¹

"The chief accounting officer...(the controller) is the logical official to be placed in charge of the budget procedure. The reasons for this selection may be stated as follows:

1. His purview extends to all functions of the business.
2. Since he is primarily a staff officer, he is detached from functional responsibility and therefore he is best able to maintain a neutral, unprejudiced, and unbiased attitude.
3. Budgets are based largely on past experience. One of the chief tasks of the controller is to collect, analyze, and interpret data relative to past performance and to translate this

¹Bartizal, John H. Budget Principles and Procedure. (New York: Prentice-hall Inc., 1940)

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- information into useful signals for the future.
4. The controller is, or at least by the nature of his training and experience should be, the best analyst in the company.
 5. He is in a position to translate proposed plans into their effect upon operating results and financial position.

In (some organizations) an official may be designated to devote his entire time to budgeting. Such an official should generally be under the jurisdiction of the controller. Such officials are sometimes designated as assistants to the president and made directly responsible to the president. While the planning procedure should logically be in charge of the controller, this should be the case only when the controller is alert to his full opportunities and responsibilities. If he is not, someone else must be selected."¹

"Specifically, the duties of the controller in relation to budgeting may be stated as follows:

1. Prepare all necessary forms, schedules, and manuals of instruction necessary for carrying forth the budgeting procedure. This should cover all procedure relating to preliminary suggestions, review, revision, adoption, and transmittal.
2. Supply all executives, major and minor, with such analysis of past operations as may be useful in determining future plans and assist in the interpretation of these data.
3. Translate proposed policies and plans into their detailed requirements and their probable effect upon operating results and financial condition.
4. Receive preliminary estimates, transmit them through the proper channels for review and revision, and transmit final plans to those concerned.
5. Keep all executives informed as to the execution of the budget. Analyze the variances between the budgeted and actual results and, in so far as possible, interpret these variances in relation to cause and effect.

¹Heckert, J. Brooks, Business Budgeting and Control (New York: Ronald Press Company, 1946) pp. 21-22

6. Initiate prompt revision of the budget, as circumstances require, in order to maintain a coordinated program.

To perform these duties efficiently, the controller must be an accurate analyst and a sympathetic counselor."

At this point it might be well to point out that another method of control is in the field of Standard Costs. Such costs are based on an estimate of the potential costs (not the ideal costs) projected into a future period. It covers all costs, including overhead; but its use is mainly in the field of unit costs of production. Various attempts are being made to apply the general idea of standard costs to Distribution Costs. One of the difficulties in such application is the fact that these costs are much more variable than production costs. It is true that they can be held at a set limit by decree, but in that event there is little relation between the outlay and the results; for instance, advertising budgets can be limited whereas a greater outlay might produce a much greater sales volume. Such costs are more intangible than production

costs, particularly in relation to unit product.

Competition could force a complete change.

Responsibility for the budget lies with top management. The comptroller is the coordinator, and as such he must be most careful to remain impersonal and to present ideas fairly. Coordination should include agreement between the comptroller as the man in charge of the budget, and others whose operation indirectly affect the primary operation.

"Sales and expense budget (resulting in the profit-and-loss budget), cash and capital-outlay budgets are the four principal divisions of industrial budgetary control, each of which is incomplete without the other three."¹

Overhead control is found primarily in the various expense budgets. Budgets are a means of improving performance. By the process of setting up a plan for future operations, using as the basis an estimate of practical operating efficiency, improved performance becomes the goal. The first place to look in preparing an expense budget is last period performance. That were

¹ Rautenstrauch and Villers, Raymond, Budgetary

should, accordingly, be referred to and passed.

Our mission must be a complete success.

Responsibility for the matter lies with

the Government. The Government is the coordinator, and

it must be made to take action in the interest of the

to prevent (and limit). Government should be

agreement between the Government and the private sector

of the country, and others who are interested in the

the primary situation.

"This is a very important document in the
history of the country, and it is a very
important document in the history of the
country. It is a very important document
in the history of the country, and it is
a very important document in the history
of the country."

Over the years, the Government has been

various economic conditions. The Government

has been able to achieve a number of

also for the country, and it is a very

system of economic development, and it

has been able to achieve a number of

the country, and it is a very important

the conditions, and what were the costs? Does any improvement suggest itself? The next point is to forecast the future conditions. The expense budget should be set up so as to be useful under several conditions, because production and sales will usually vary. Expense per item should normally be lower as the rate of production becomes higher. On the other hand, competition might force greater advertising outlays. The point is that the forecasted expenditures can be in error and provision should be made to leave an alternate course available if needed.

The budget for a production shop considers two features--the total overhead expense under sets of various conditions and the volume of production to be maintained. In other words, the total expense is stated in terms of its proportionment to the units produced. There are two types of overhead expenses in the shops. The first includes the indirect charges directly related to the shop and so identified, the second includes the various charges not identified with the shop but which are proportioned among the shops on the basis of estimates. This latter type includes the proportioned share of service department expenses. There are many ways of

distributing such shares of expenses. Heat might be on the basis of shop space, industrial relations on the basis of the number of employees, electricity on the basis of meters measuring the actual amount used. But both types are included in the one total which is applied to the units of production included in the costs of manufacture. Past experience should indicate the best method of applying those costs to the products. There are several methods of application--the ratio of the costs to the costs of direct material or to direct labor, and to direct labor hours or to machine time--the use of which is dependent on which is the most suitable for the particular shop. There are many considerations which will effect the final choice.

Past experience should indicate the costs in many instances to be included in the budget. These past costs will be interpreted in the light of changed production schedules, newer machinery, proposed improvements, and the like.

Finally, the budget should be prepared so as to reflect the various levels of production. At lower levels, the fixed and semi-fixed overhead expenses tend to be more important in the total costs, while the variable expenses tend to increase in proportion to the volume of production. The budget serves another purpose in that it is possible to indicate the savings to be had

the basis of such speed, industrial relations on the basis of the number of employees, classified on the basis of many factors for several years past. The last types are included in the general index applied to the study of operations included in the study of manufacturing. This suggestion would include the last called of applying these costs to the products. There are several methods of calculation--the study of the study to the costs of direct material in the direct labor, and to direct labor hours or to machine time--the use of which is dependent on which is the most suitable for the particular shop. There are many considerations which affect the study of costs.

by the replacement of equipment and facilities gaining the benefits of technological improvements when the volume of production reaches a point where the suggested change would be profitable.

In a producing shop, the overhead expenses should be set so as to have the data suitable for each of the possible levels of production. The classifications of production expenses must be measured in terms of the volume of the various items produced. Previous experience should indicate the fixed overhead figure after considering any basic changes such as new equipment, major overhauls, and so forth. Maintenance costs and supervisory costs generally should be related to previous experience, however they do not necessarily follow the pattern of production. Maintenance costs have little relation to production other than the wear and tear occasioned by the production process. Supervisory costs have more relation to the number of employees, but the figure is not necessarily constant in that a foreman can supervise a variable number of men up to a point where it becomes advisable to add an extra gang. Light and power should follow the production pattern, while heat depends on the weather--the former can be controlled while the latter is dependent on outside forces although it can be estimated over a year and applied monthly.

An expense budget is only a part of the whole

by the replacement of wood used in building.

The benefit of the proposed improvement is that the

value of the building is increased by the improvement.

There will be no objection.

In a building, the value of the building is increased

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At present, the building is improved by the improvement

budget, and is dependent on other parts of the budget. The business should adopt the whole budget program if applicable. The starting point in the budget program is the forecast and the adoption of a set goal by management. The forecast and goal includes the anticipated sales data, at set quantities and values. Since the price most often has a bearing on the volume, the schedule should indicate the several possibilities in order that management will have those facts available for guidance in its decision.

In light of the potential volume of sales, management coordinates the surveys of the production facilities, the inventory, and the expenses which must be met during the period in question. These items of expense such as depreciation and insurance, taxes and interest charges which must be met regardless of the volume of business. Volume might be so low that management might decide to sublet a portion of the production or a decision might be made either to seek new lines of production or to expand facilities.

The production budget is prepared in light of the proposed volume or inventory accumulations. Costs are accumulated for production at the proposed level. The service departments likewise accumulate their costs of operation to meet that level of production. And Administrative overhead costs are calculated for inclusion in the totals. Management then determines the programs

subject, and it is therefore in the nature of a review.
The Institute should have this study program in
agreement. The study should be in the nature of a review.
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for the ensuing period. From the cost schedules which have been submitted, approved budgets are released to the various departments and to the sections which are concerned.

The Controller has a great interest in the proceedings as they have gone along. The accounting records were the source of a large proportion of the historical record of costs which served as a basis of estimating the future costs. Records of depreciation, taxes, insurance, and the like were made available in the necessary and desired form. Cost accounting records for proposed items or similar items to be produced are made available for use in computation of future probable costs. The economic situation, the rates for labor, machine costs, building costs, interest rates, and a host of similar items are all considered and noted in appropriate information schedules to serve as a guide to the various departments in the preparation of their budget estimates. A representative of the budget section should be available to the other departments to furnish any information necessary and to advise as requested. The Controller and his representatives represent the management and should know any and all pertinent policies. It should be pointed out that much of the budget representative's success depends on his selling himself and the budget program to the individuals in the various departments. He must gain their cooperation and in turn he must

cooperate with them. In other words, he must ensure that the operating departments know that their desires and difficulties will be reflected in the presentation to the top management.

operate with them in their work, on such cases
that the operating department may that their design
and situation will be referred in the presentation
to the top management.

V. USE OF THE BUDGET

"The adoption of a budget should never result in standardization to the point where appropriate adjustments and changes are not possible. Industry is always in a state of flux in the sense that new methods and means of operation in production and marketing are frequently developed and adopted during the year, and any company in any given industry should adapt itself to new conditions as they appear, and adjust its budget accordingly."

It follows that the budget should be kept up-to-date and it should reflect the current conditions of doing business. By being responsive to the current conditions, the budget becomes an instrument of control. As an instrument of control, the costs of doing business must be kept current and must be reported promptly to those in a position of control for comparison with the previous estimates. It should be recognized that the budget is a forecast and an estimate, and that estimates being what they are, are subject to error. However, a significant difference between the estimated cost and the actual cost should always be investigated and explained, and if the explanation is not adequate, the situation causing the difference should be corrected. Near the close of this paper, the effects of a budget on people is discussed. If the people do not go along with the principle of budgeting, they are apt to alibi any and all differences rather than to recognize the cause.

¹Rautenstrauch, Walter and Villers, Raymond, op. cit.

The budget data and the actual expense data should be furnished to the lowest level of supervision in a form suitable for use at that level and directed toward the interests of that level. Top management should be furnished data covering the total costs in relation to the budgeted costs broken down to the levels directly under their supervision. Department heads would be interested in the cost comparisons of the levels under their supervision. The man in charge of the shop is interested in the comparison of the costs in his shop, while the foreman is interested in the comparison of the costs in his area of work. Since a budget is a plan of operations, efforts should be directed toward living within the plan. The possibilities for control will vary at each of the levels of supervision. The foreman will do his work under standard costs, but he will be in a position to cut down on miscellaneous expenses or on requests to service departments.

The budget was not the subject of discussion.

It was decided to hold a meeting of the committee.

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VI. PEOPLE WHO ARE CONTROLLED BY THE BUDGET

One of the troubles with a budget is that those who must live with it and make their plans in accordance with its provisions generally have little knowledge of budgetary application.

The School of Business and Public Administration of Cornell University prepared for Controller Foundation, Inc. a study of The Impact of Budgets on People. It is an interesting study of the effects of a budget, which is a technique of planning and control of the complex operations of today's business corporation, and which apparently has been underestimated. The study makes the point that controls will work only when the people make them work. "The average controller would not have reached his present status as part of the management team, if he had not possessed a far greater degree of salesmanship and insight into human relations than the average employee in the accounting phase of corporate management." One of the purposes of the study was to give management an answer to the question "--how to gain acceptance--real acceptance of standards and goals."

To this end, the study first sought to discover

what the various people concerned think of budgets. The budget man sees a budget as improving performance, instituting improvements quickly, putting pressure on factory supervisions, and giving the factory personnel a goal to reach. The factory supervisor sees the budget as a symbol of pressure which will be feared or resented, which in turn could lead to decreased production. He conceals a budget from his workers.

The budget man seems to feel that the solution lies in "educating or training factory people in the appreciation and use of budgets." The factory man on the other hand feels that his point of view is not fully appreciated because the budget man has had no taste of factory problems and has no idea of what really goes on.

The study revealed at least three highly significant problems

- "1. The problem of pressure
2. Success for budget supervisors means failure for factory supervisors
3. The problem of department-centered supervisors"

People resent having to work under pressure, and since the budget is viewed by the worker as an instrument of pressure, they resent the budget. That the success of budget supervisors means failure of factory supervisors is a matter depending on the individual. It might be assumed that the man who feels he has failed has really

that the various people concerned with it should be
 budget was made a subject of intensive discussion, and
 certain improvements were made, but the system of budget
 management, and since the budget system is not to
 reach. The budget management was the subject of a series
 of measures which will be found in paragraph 10, and in
 fact would lead to increased production. It was also
 subject to the same.

The subject was also to find that the solution
 lies in reduction or reduction of budgetary needs in the
 appropriation and use of resources. The budget was not
 the other hand, that the solution is not to find
 increased production of output and the same, but to
 reduce production and hence the use of resources, and so
 the study required at least three things

essential problems

1. The problem of production

2. The problem of budgetary management and control

3. The problem of financial management

4. The problem of financial management

These three things are not only important, but
 they are also the subject of the budget. The subject of
 of economy, that is, the budget. That the subject of
 budgetary management is the subject of budgetary management
 is a subject of the budget. It is also the subject of
 the budget, and the subject of the budget is the subject of
 the budget.

tried to do a good job. At any rate, most people want to feel they are successful. Factory "supervisors are partially evaluated by budget records," and he feels that he must meet the goals of the budget. By this process, the supervisor is trying to live within his budget, becomes concerned more and more with his own small sphere and his considerations are used in comparison "against" other areas of work. As a practical matter, the supervisor should plan his work to fit in with the whole plant-wide operation. The complete organization should consist of harmonious parts, but "budget records, as administered, foster a narrow viewpoint on the part of the user."

The study concluded that the solution of the problem would require much further research, and suggested that ways be investigated that would permit supervisory participation in the preparation and would encourage acceptance of the budgeting principle.

The foregoing made reference mainly to factory procedure, and undoubtedly covered production budgets. The same ideas, however, would apply to any budget which affected more than just a few people. One of the most important things having to do with an overhead budget is to convince the individuals who work under it that it is a guide and a goal based on sound estimates and sound reasoning. It follows that if those individuals were "in"

on the reasoning and estimating, they would be in a position of having to live with their handiwork. This coupled with the recognition extended by virtue of sitting in on the original proceedings should tend to make the budget a successful instrument.

People who are interested in their work quite naturally resent intrusion by "outsiders" who they feel "don't know what they're talking about." The budget man should set to be an "insider" with the users.

on the reasoning and estimation, they could be in a position of having to live with their neighbors. This would also be the reason why it was so difficult to find the original source of the trouble.

VII. APPLICATION TO THE NAVY

Overhead expenses in the Department of the Navy will fall into each one of the various categories, and any principles used in business can be applied with equal effect. Other than the principle of expense control, the budget is the means whereby the Navy gets its operating funds--through Congressional Appropriations.

The Navy has many industrial establishments--the navy shipyards and ordnance plants are some examples which are subject to industrial cost accounting and amenable to budgetary control. The establishment of the Navy Industrial fund in such establishments will make necessary more use of budgetary control.

The costs of maintaining the Navy Supply System parallel the costs of commercial distribution in many respects. The principle difference being that the object of the former is to supply the fleet, and the object of the latter is to make sales, but in either event the object is to have material at the right place when needed. One might mention the absence of advertising--but what is the Catalogue of Navy Material?

Administrative expenses will apply to the bureaus

and offices of the Navy, to the Industrial Relations Divisions at shipyards, and so forth. Even though finance costs themselves are not applicable to the Navy, the reasoning should be applied, if for no other reason than to indicate the wise use of the various funds.

and office of the Navy, in the Federal Relations
Division at Washington, and as far as the Navy
Finance cases themselves are not applicable to the Navy,
the question should be settled, if for no other reason
than to indicate the state of the various funds.

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